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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1941.

No. 941.

THE D. W. KLEIN COMPANY, a Corporation, *Petitioner*,

v.

GUY T. HELVERING, Commissioner of Internal Revenue, *Respondent*.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

PETITIONER'S REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

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THE McQUESSIN PRESS.

CASES CITED.

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The Respondent's argument that the taxpayer did not acquire the assets of the bankrupt corporation in a reorganization under Section 112 (i) (1) of the Revenue Act of 1932 is based upon the false premise that there was no plan of reorganization of the Royal Cloak Company prepared and adopted by the officers and stockholders of the corporation prior to the adjudication of *voluntary* bankruptcy.

The Board of Tax Appeals in its opinion did not deny that there was a plan of reorganization, but erroneously stated that "there was no plan of reorganization carried through which included a continuation of the interests of the Royal Cloak Company or its stockholders in the petitioner." (R. 112.)

The series of transactions evidencing the adoption of a plan of reorganization before the adjudication of voluntary bankruptcy and the acquisition of the properties by this taxpayer

pursuant to that plan, are related and set forth as undisputed facts in the Board's findings (R. 101–103), to wit:

(1) The submission by the officers of the corporation to counsel of a plan for reorganization of the Royal Cloak Company to eliminate the unprofitable stores.

(2) The recommendation by counsel that the company make a common law assignment of its assets for the benefit of creditors, which was done by instrument executed November 14, 1931. (Pet. Ex. 1; R. 80–83.)

(3) The filing by the corporation four days later, November 18, 1931, of a voluntary petition in bankruptcy at Peoria, Illinois, in order to forestall involuntary bankruptcy proceedings in Iowa.

(4) The appointment by the Court as Receiver and as Trustee in bankruptcy of the same person, Harry A. Frankel, who was trustee under the common law assignment.

(5) The continuous operation by the Receiver and Trustee of the two principal stores until the sale of the assets in January, 1932, to Mrs. D. W. Klein, the sole owner of the Class A preferred stock of the Royal Cloak Company.

(6) The organization of the taxpayer and the transfer of the assets to it in February, 1932, by Mrs. Klein in exchange for all of the stock and the assumption of her liability to the trustee.

Mrs. Klein as the sole owner of the Class A preferred stock of the Royal Cloak Company, had the preference right to the assets in liquidation, so that she had an equitable interest in the assets in liquidation, which under the plan of reorganization she effectually continued in the new company. The assets were not of sufficient value to give the other stockholders any interest.

The separate steps of the plan whereby the taxpayer acquired all of the assets of the Royal Cloak Company pursuant

to a reorganization plan consummated with the aid of the bankruptcy court, through the purchase of the assets by Mrs. Klein at trustee's sale, were integrated parts of a single plan and constitute a "reorganization" within the meaning of the statute. *Helvering* v. *Alabama Asphaltic Limestone Co.*, No. 328, October Term 1941, decided by this Court on February 2, 1942.

The Court below in its opinion recognized the existence of the foregoing transactions by the following statement (R. 164):

> "The discussion among the stockholders before the proceedings were determined upon, and their decision to initiate them as a part of what they called a plan of reorganization, acting upon advice of counsel, does not alter the character of those proceedings as actually carried out."

Also, the Court below in its opinion stated that the case presented the question, whether the facts fall within the definition of a reorganization provided by Clause B of Sec. 112 (i) (1): "a transfer *by a corporation* of all or a part of its assets *to another corporation* if immediately after the transfer the *transferor or its stockholders* or both are in control of the corporation to which the assets are transferred * * " (italics ours) (R. 162). That was the same question decided by this Court in *Helvering* v. *Alabama Asphaltic Limestone Co.*, *supra*, under a state of facts very similar to those in the present case. There the old corporation was a subsidiary of a corporation that was in receivership, the stockholders of which had financed the old corporation by taking unsecured notes for their advances. A creditor's committee was formed, a plan of reorganization was proposed providing for a new corporation to be formed and the transfer to it of all of the assets of the old corporation in exchange for stock which would be issued to creditors in satisfaction of their claims. All note holders assented, except two, and involuntary bankruptcy proceedings were instituted. The bankruptcy assets, having a value of $155,000, were offered for sale at public auction by the bankruptcy trustee and were bid in by the creditor's committee

for $15,000 cash. The bankrupt's obligations were about $838,000. Thereafter the new corporation was formed and acquired the said assets in exchange for stock which was distributed to the creditors.

Thus, in that case, if there were substituted for the creditors, a stockholder having an equitable interest in the assets, and the involuntary bankruptcy proceedings were changed to voluntary bankruptcy proceedings, the situation would be almost identical with the present case.

A similar situation also prevailed in the case of *Palm Springs Holding Corp.* v. *Commissioner of Internal Revenue*, No. 503, October Term 1941, decided February 2, 1942, which was held to be a reorganization under Sec. 112 (i) (1) A of the Revenue Act of 1932.

The respondent states (page 8) that the decision of the Court below is not inconsistent with its own previous decisions in *Commissioner* v. *Kitselman* (C. C. A. 7), 89 F. (2d) 458, and *Rex Manufacturing Co.* v. *Commissioner* (C. C. A. 7), 102 F. (2d) 325, but fails to state the reasons, except to make reference to a brief filed with this Court in *Mascot Stove Company* v. *Helvering*, No. 564, present Term, in opposition to a petition for writ of certiorari for review of a decision of the Sixth Circuit.

The case of the *Mascot Stove Company* v. *Commissioner* (C. C. A. 6), 120 F. (2d) 153, turned upon a question of fact. The *Mascot case* was an involuntary adjudication in bankruptcy, that was not planned as a step "in pursuance of a plan of reorganization." On the contrary, after the adjudication in bankruptcy, a plan was formulated by the stockholders for the acquisition of the assets by one Ziegler, as trustee or agent for the stockholders, and their transfer to a new company to continue the business. There was no plan of reorganization conceived or instituted until after the corporation became a bankrupt, and then Mr. Ziegler bought the assets from the trustee in bankruptcy and transferred them to a new corporation; and while it was true the old stockholders were permitted to become stockholders in the new company, it was not by virtue of any plan of reorganization of the old corporation.

The involuntary bankruptcy proceedings were not planned as a part of the reorganization of the old corporation as in the case of *Helvering* v. *Alabama Asphaltic Limestone Co., supra*. Thus, the assets were not properties of the bankrupt corporation at the time of the transfer to the new corporation within the meaning of the reorganization statute, but were properties of Ziegler as trustee or agent for the stockholders. The same situation prevailed in the cases of *Bondholders Committee, Marlborough Investment Co.* v. *Commissioner* and *Marlborough House, Inc.* v. *Commissioner*, Nos. 128 and 129, October Term 1941, decided February 2, 1942, and this Court made the point in distinguishing those cases from its decision in *Helvering* v. *Alabama Asphaltic Limestone Co., supra*.

The facts in the case of *Rex Manufacturing Co.* v. *Commissioner, supra*, are similar to those in the present case. The Rex Manufacturing Company, which had been engaged in business since 1898, became involved in financial difficulties during the business depression in 1930, and while its books showed assets between $600,000 and $700,000 and less than $200,000 of liabilities, it concluded its difficulties could best be solved by bankruptcy proceedings, and the formation of the successor corporation which would purchase the assets at bankruptcy sale; the plan was perfected, carried out and the bankruptcy sale held on July 10, 1930, a nominee purchased the property and thereafter conveyed it to the newly formed company, the same persons holding a beneficial interest or control in fifty per cent or more of stock of the new company equal to or in excess of that amount.

Respectfully submitted,

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